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SUBJECT: KUWAIT ECONOMIC UPDATE - JUNE 2009

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¶1. (SBU) Summary and Comment:

-Despite high profile defaults, Kuwait continues to be spared most of the ravages of the global financial crisis. S&P recently reaffirmed its "AA-/A-1 " ratings, citing Kuwait's "robust external balances."

-Current oil prices will likely produce a budget surplus for FY 2009-10.

-The GOK's $5.2 billion "financial stimulus" law appears to be much ado about nothing. Restrictive terms and weak incentives render the package unappealing to borrowers and lenders, respectively.

-A slew of canceled energy and infrastructure projects has further exacerbated Kuwait's reputation as a frustrating -- and risky -- place to do business.

End Summary and Comment.

WEATHERING THE STORM

¶2. (SBU) Kuwait is weathering the global financial crisis relatively well. While the IMF forecasts a 1.1% 2009 GDP contraction, Kuwait is not suffering the significant economic and social dislocation seen in the U.S. and other OECD economies. With 90-95% of the Kuwait workforce employed by the state, concerns over rising unemployment are virtually non-existent. With oil prices hovering around $60 and looking to edge up over the summer months, analysts -- including the IMF and the National Bank of Kuwait (NBK) -- anticipate that Kuwait will enjoy yet another budget surplus for FY 2009-2010.

¶3. (SBU) Liquidity is not a problem for the GOK, whose net asset position is 250% of GDP, according to Standard and Poor's, which recently reaffirmed its "AA-/A-1 " ratings on Kuwait. S&P also states that Kuwait's net external assets are close to 425% of current account receipts, "underscoring robust external balances." Low stock prices notwithstanding, Kuwait's banking sector has, for the most part, survived the global financial crisis intact. Other than a modest infusion of funds into Gulf Bank (following currency trading losses in fall 2008) by the Kuwait Investment Authority, the GOK's SWF, none of Kuwait's banks have required Government bailouts. While balance sheets continue to remain fairly robust, some bankers acknowledge that more than a couple of Kuwait's banks

may have negative exposure to some of Kuwait's troubled investment firms (e.g., Global Investment House and Dar Investment), the local real estate market and the ailing Al-Gosaibi and Saad groups in KSA (see below).

¶4. (SBU) In numerous conversations, Post's interlocutors -- while lamenting the multitude of bureaucratic and political obstacles to enterprise and entrepreneurship in Kuwait -- acknowledge that business conditions in Kuwait probably helped to prevent the rampant speculation that has wrought such damage on Dubai's economy, which had been a destination for considerable Kuwaiti investments.

WHITHER THE GOK'S FINANCIAL STIMULUS LAW?

¶5. (SBU) The GOK's $5.2 billion financial stimulus package -- promulgated via Amiri decree in late March to boost corporate lending (ref 312 and 111) -- is living up to skeptics' predictions that it would be little more than a legislative white elephant. More than a dozen sources in the financial services sector have told Econoffs that the law provides scant incentive for banks to increase lending to Kuwait's troubled investment companies and other ailing firms. Some bankers also point out that the law's vague implementing regulations do not provide long-term assurances to lenders, i.e., the procedures for claiming GOK-sponsored guarantees in the event of defaults are poorly spelled out. The head of one of Kuwait's largest investment companies said the law put too many onerous restrictions on companies seeking short-term relief and predicted that no financial services firms would

benefit from the law.

¶6. (SBU) The failure of the new National Assembly (elected May 16) to formally ratify the law is also compounding banks' reluctance to lend funds under the provisos of the law. The GOK promulgated the law via Amiri decree after the Amir dissolved Parliament in March and the newly elected National Assembly -- which is constitutionally mandated to approve or reject all such decrees -- had been expected to consider the law during the week of June 14. However, increasingly it appears that such deliberations will be put off until after Ramadan, i.e., in September or October. Meanwhile, MPs have resumed their calls for mass debt relief for Kuwaiti citizens, an oft-heard cry in the old Parliament (ref A). Earlier in the year, several GOK Ministers voiced opposition to such suggestions.

KUWAIT OR "QUEUE AND WAIT"?

¶7. (SBU) The cancellation of the K-Dow joint venture, the Al-Zour Fourth Refinery project and the Subiya power plant projects coincided with the release of data from UNCTAD, which showed a paltry $123 million of FDI in Kuwait in 2007 (by far the worst showing in Middle East and North Africa). All this exacerbated Kuwait's reputation as a difficult place to do business, not least in the U.S. and East Asia, where large firms such as Dow Chemical Co., Flour Corp., GS Engineering & Construction (of Korea) and JGC Corp. (of Japan) all fell victim to canceled projects after making initial investments in such projects.

¶8. (SBU) More than three dozen contacts in the Kuwaiti commercial and banking sectors told Econoffs that they shared foreign firms' exasperation with the business climate in Kuwait. In most cases, our interlocutors highlighted the numerous bureaucratic obstacles to starting new businesses, buying and/or developing real estate and securing licenses and permits. Such obstacles were usually described as being a combination of bureaucratic inertia and inefficiency, high turnover of Ministers, overlapping and competing jurisdictions of Ministries, and moderate corruption. The

interminable tensions between the executive and legislative branches of the GOK was also cited as a major obstacle. Finally, some businessmen from the old merchant families lamented the power now being wielded by senior bureaucrats from Bedouin families with "short" histories in Kuwait. (Note: The World Bank's 2009 Doing Business report ranks Kuwait 52nd out of 181 for "ease of doing business" and 134th for "starting a business." End Note).

¶9. (SBU) Several interlocutors told Econoffs that Kuwait's FDI inflows need to be viewed in the context of Kuwait's recent history, citing the Iran-Iraq war, the Iraqi invasion of Kuwait, Operation Iraqi Freedom and ongoing tensions between the Gulf's Arab states and Kuwait's neighbor Iran -- all of which have contributed to significant geopolitical risk perceptions. (Note: S&P's recent rating reports also referenced such risk factors though the report noted that these were mitigated by Kuwait's "good international alliances." Kuwait enjoys excellent relations with the U.S., the UK and France. End Note).

BANKS' NEGATIVE EXPOSURE

¶10. (SBU) International media have widely covered the financial troubles afflicting the Saad and Al-Gosaibi groups in KSA (ref B). Local media reported that the Central Bank instructed Kuwaiti banks to cease dealings with the two Saudi firms. Post's banking sector contacts confirmed that the Central Bank has asked local banks to declare their exposure to Saad Group and Algosaibi Group and expressed concern that they might need to increase their "extraordinary" provisions. The extent of Kuwaiti banks' exposure is not clear at this time, though a contact at Gulf Bank indicated that his bank's exposure was "large."

¶11. (SBU) Kuwait's largest investment company, Global Investment House, announced a major capital hike June 15, in an effort to raise funds to help pay off close to $3 billion in short- and mid-term obligations (ref C).

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